Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

Initial Comments of the Indiana Utility Regulatory Commission on the Further Notice of Proposed Rulemaking on Intercarrier Compensation

I. Scope of Comments

On March 3, 2005, the FCC released a Further Notice of Proposed Rulemaking ("*FNPRM*") in this proceeding, asking for comment on a variety of issues.[1] These initial comments of the Indiana Utility Regulatory Commission ("IURC") will focus on two areas: (1) describing the history, work, and process of the NARUC Task Force on Intercarrier Compensation and (2) identifying and explaining certain flaws in, and implications of, a recent FCC staff document on intercarrier compensation.

II. The NARUC Task Force on Intercarrier Compensation Explored Intercarrier Compensation Options through a Process of Education, Compromise, and Balance.

The NARUC Task Force on Intercarrier Compensation ("Task Force") arose from informal discussions in the winter of 2003-04. After formally organizing under the leadership of Commissioner Elliott Smith from the Iowa Utilities Board, participation by state Commissions grew significantly, including active and continuing involvement from state Commissioners and staff.[2] Participation on the part of industry and other stakeholders also grew considerably with each successive meeting of the Task Force.[3]

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[1] *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, FCC 05-33 (rel. Mar. 3, 2005) ("*FNPRM*").

[2] The following states and territory were represented by Commissioners and/or staff: Alaska, California, Idaho, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Nebraska, New York, North Dakota, Oregon, Pennsylvania, Puerto Rico, Montana, Vermont, Washington, and Wisconsin.

[3] A number of organizations that have participated filed comprehensive plans in this proceeding, including: ARIC; CBICC; EPG (which has since merged with ARIC to form the Rural Coalition); ICF; and NASUCA. Others filed less extensive comments. Individual organizations participating in the Task Force's efforts include: (1) Associations: ALTS, CTIA, Iowa Telecommunications Association, ITTA, Montana Independent Telecommunications Systems, Montana Telecommunications Association, NCTA, NECA, North Dakota Association of Telecommunications Cooperatives, NTCA, Rural Iowa Independent Telephone Association, VON Coalition, and Western Telecommunications Alliance; (2) RBOCs: Bell South, Qwest, SBC, and Verizon; (3) RLECs: CenturyTel, Consolidated Telephone Company, Great Plains Communications, Iowa Telecom, TelAlaska and TDS Telecom; (4) IXCs and CLECs: AT&T, Centennial Communications, GCI, KMC Telecom, Level 3 Communications, MCI, Pac West, Sprint, US LEC, and Xspedius Communications; (5) Cable MSOs/ISPs: Cox Communications and Earthlink; (6) Wireless: T-Mobile, US Cellular, and Western Wireless; (7) Consumer Organizations: D.C. People's Counsel, Ohio Consumers' Counsel, and Montana Consumer Counsel; (8) Counsel/Consultants for Stakeholders: Cole, Raywid & Braverman, LLP, Fred Williamson & Associates, Harris,

Throughout the process, it was emphasized that participation did not necessarily constitute endorsement on the part of stakeholder participants in any specific proposals or filings from members of the NARUC Task Force. However, discussions among the Task Force and various stakeholders allowed for exploration of the differences and commonalities among the parties, identification of strengths and weaknesses of the various plans which have been filed in this proceeding, and provided a reasonable framework for open continued dialogue. The process was especially productive when participants moved beyond merely restating their formally filed positions and public stances on intercarrier compensation issues to volunteer constructive commentary, insights and perspectives based on their extensive collective and individual industry experience.

The Task Force set out to develop a set of principles around which the various state Commissions could coalesce, and to provide a benchmark for evaluating any intercarrier compensation proposals which might be developed later. These Task Force principles were filed with the FCC as an *ex parte* filing on May 5, 2004. Panel discussions took place on July 11-14, 2004, which were later christened "Workshop I" after a series of events were planned.[4] During Workshops II, III, and IV, the format shifted to allow the parties to allow presentation and critiques of various plans and proposals. This unprecedented free exchange of ideas enabled each group to understand the differences among the plans, in addition to offering a constructive counter-balance of varying perspectives.

At the express request of many of the stakeholders who had been participating in the Workshops, state Commissioners and staff developed a "strawman" proposal for discussion within the Task Force. The strawman proposal then became the basis for further discussion and development within the Task Force throughout the late fall and winter of 2004. On March 1, 2005, the Task Force submitted an *ex parte* filing to the FCC, containing Version 5 of the Task Force proposal. Shortly thereafter, the FCC released its *FNPRM* in this proceeding. Task Force work groups are continuing discussions on outstanding issues in an effort to reach a compromise on a revised proposal.

This continuous process of refinement has enabled the Task Force to reach compromises on the issues it presented to the FCC. This invaluable experience was rich with debate, and ultimately resulted in a fair and balanced approach to intercarrier compensation. The strength of this process lies in the manner in which the Task Force dealt with all state commissioners and staff members and with stakeholders. While the Task Force process is a model for dealing with complex regulatory issues, it is also reflective of the tremendous amount of work done those whose plans came before the Task Force. It is on their shoulders that the Task Force was able to stand and explore options through a process of education, compromise and balance. On May 18, 2005, the Task Force filed Version VII of its intercarrier compensation proposal with the FCC.

Wiltshire & Grannis, Latham & Watkins, McLean & Brown, NRRI, Parrino Strategic Consulting Group, Swidler Berlin, LLP, and Womble Carlyle Sandridge & Rice, PLLC. We have attempted to acknowledge the valuable participation of all parties; we regret any errors or omissions that may have occurred from this list.

[4] Workshop II was held in Missoula, Montana, on September 10-11, 2004. Additional workshops were held in Washington, D.C. (Workshop III, on October 27-28, 2004); Nashville, Tennessee (Workshop IV, November 12-13, 2004); and in Washington, D.C. (Workshops V, January 25-26, 2005 and VI, April 21-22, 2005).

The Task Force anticipates holding at least one more intercarrier compensation workshop (Workshop VII) in the next few months, with Task Force members, other interested commissioners and staff, and industry, association, and consumer stakeholders.

III. *Appendix C* is a Seriously Flawed Proposal that is Not Well Supported.

The *FNPRM* asks for comment on a number of changes that might be made to the existing intercarrier compensation framework. In addition, an FCC staff report was attached to the *FNPRM* that focuses on the question of whether a regime with a compensation rate of zero is preferable to one with a positive compensation rate.[5] This staff report is labeled "*Appendix C*" to the *FNPRM*. *Appendix C* notes that "In response to the *Intercarrier Compensation NPRM* [released on April 27, 2001], many parties submitted comments on the relative merits of Bill-and-Keep and a unified CPNP [calling party's network pays] approach to intercarrier compensation reform."[6] The Wireline Competition Bureau staff developed *Appendix C* as an analysis of the record on Bill-and-Keep that was offered to aid in further consideration of intercarrier compensation issues.[7] We note, however, that *Appendix C* is not the product of an FCC vote, does not represent the views of, and is not endorsed by, the FCC.[8]

Appendix C argues that intercarrier compensation should be based upon a "Bill-and-Keep" methodology.[9] Bill-and-Keep can be thought of as a unified compensation regime with a rate of zero. Under a Bill-and-Keep regime, carriers do not charge each other for the origination and termination of traffic. Rather, carriers recover all their costs from their subscribers. The approach in *Appendix C* appears to rest on several critical principles, including: (1) that customers benefit from both originating and terminating traffic on ILEC networks; and (2) that incremental costs of originating and terminating traffic are zero, or close to zero. When end users make or receive calls they are classified as customers or subscribers. However, competitors such as other carriers and providers, while also originating and terminating traffic over ILEC networks, are classified as competitors instead of as customers. Consistent with these principles, FCC Staff answered in the affirmative the earlier question of whether a regime with a compensation rate of zero is preferable to one with a positive compensation rate.

A. Competitors are also Customers of ILECs, but are Treated Differently than Traditional Customers under the *Appendix C* Analysis.

Classifying customers and competitors in this way misses several critical points. First, toll carriers such as IXCs and other providers, although they may be competitors of the ILECs,

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[5] *FNPRM* at 98, n. 3.

[6] Id. at 98.

[7] Id. at 106. See also, *Appendix C* at 98.

[8] Id. at 106 and 113. See, also, *Appendix C* at 98.

[9] Throughout *Appendix C*, FCC staff sets up a dichotomy between a Bill-and-Keep approach and an approach they refer to as "Calling Party's Network Pays" ("CPNP"). While we believe that the Bill-and-Keep approach is deeply flawed and is not well supported, we believe this approach may set up a false dichotomy; following this line of thinking could lead to excluding other potentially meritorious alternatives.

are also *customers* of ILECs. These toll carrier/provider customers of the ILECs are just as likely to benefit from using ILEC network facilities to originate and terminate traffic as retail, end user customers. Indeed, it is *because* of this customer-supplier relationship that toll carriers and providers pay compensation to ILECs today. In a competitive relationship between an ILEC and a CLEC, reciprocal compensation payments may be made for transport and termination of traffic. The proposed Bill-and-Keep policy discriminates against one class of ILEC customer (end user customers) and favor another class of ILEC customer (toll providers) by shifting all of the network costs used to perform the originating and terminating functions to the end user customers, including those currently recovered through some form of switched access charges. The proposal also favors carriers generally by shifting all carrier transport and termination costs to end user customers.

B. Bill-and-Keep Fails to Account for Cost Causation and Sends Improper Market Signals.

Under the Bill-and-Keep methodology, the incremental cost of origination and termination is asserted to be at or close to zero.[10] *Appendix C* asserts that "it does not appear that minutes-of-use are a significant determinant of costs given developments in telecommunications technologies."[11] This assertion is applied to both loop costs and switching costs, while little or no value is assigned to either the originating or the terminating functions.[12] While the proposal does not suggest that the value of the network investment in loops and switches is zero, it does appear to assert that 100% of the value of that investment should be recovered from one class of ILEC customers. The proposal appears to force ILECs to perform those functions for, and "rent" their facilities to, other carriers at no charge. It also apparently forces carriers generally to transport and terminate each other's traffic at no charge. Both scenarios are contrary to the NARUC Intercarrier Compensation Principles Document, which states, "Intercarrier compensation should be designed to recover an appropriate portion of the requested carrier's applicable network costs. At a minimum, this will require compliance with … 47 U.S.C. 254(k)."[13]

Furthermore, if the incremental cost of origination and termination truly is at or close to zero, we must assume that applies to all customer classes for whom carriers may perform the originating and terminating functions, with no classes excluded. If the incremental cost of both origination and termination are zero, there is a question of whether this includes an assumption that local exchange rates are too high, because the typical local exchange rate is designed to recover at least a portion of the ILEC's originating and terminating costs. If that portion of the ILEC's originating and terminating costs included in local exchange rates is now zero, then the rates must be adjusted downward. There is no cost support for a bimodal cost structure, either

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[10] *FNPRM* at 100.

[11] Id. at 101-102.

[12] *Id*. at 102.

[13] The National Association of Regulatory Utility Commissioners Study Committee on Intercarrier Compensation: Goals for a New Intercarrier Compensation System, § III.B. (approved May 5, 2004; filed in CC Docket No. 01-92 on March 1, 2005 and May 23, 2005) (internal footnotes omitted).

one that is based upon customer class distinctions or one that is based upon carrier-versus-end-user distinctions. If, alternatively, the proposal shifts all network or facilities costs directly to end users, we are concerned that this may run afoul of the requirements of 47 U.S.C. § 254(k).

Even assuming *arguendo* that the incremental cost of origination and termination is at or close to zero, it is not at all clear that originating and terminating intercarrier prices should also be zero. Telecommunications is a very capital-intensive industry that often requires large network investments. Relying solely upon an incremental cost standard to set prices could result in misallocation of those network costs, under-recovery, or both. This is especially true if incremental costs are zero. Those costs should be recovered from both retail and wholesale customers, not just from retail customers.

It is not clear how literally the statement in *Appendix C* that "carriers should recover all their costs from their end user customers" should be interpreted. There is no explanation of which specific ILEC charges or rate elements currently applied to other carriers or providers should instead be applied to end user customers. We are unsure whether *Appendix C* is advocating that ILECs or other carriers be allowed to charge end user customers separately for origination, termination, switching, transport, and other similar charges. Similarly, we are unsure whether the proposal advocates a change in customer billing such that companies that do not currently bill the end user customer for functions performed on individual telephone calls or transactions will begin doing so in the future. We are very concerned about the impact such a radical change would have on end user customers. Our concern is heightened because a mandatory implementation of Bill-and-Keep is not only unadvisable but also unnecessary. Much confusion and anger would likely result if end user customers felt they suffered twice by paying for functionalities that are already currently included in the cost of local exchange service.

It is unclear whether *Appendix C* also advocates that ILECs create new retail rate elements for network functions that are presently performed in an integrated fashion (*i.e.*, origination, termination, switching, transport) in order to recover those costs separately from their end users. We are extremely skeptical of the notion that end user customers, especially residential and small business customers, have a use for piecemeal parts of the ILEC network, or for network functionalities divorced from actual services. End user customers are interested in purchasing completely integrated services from the ILEC, such as basic local exchange service. Since basic local exchange service can already be purchased today, it is unclear what benefits customers would really enjoy from being forced to pay separately for ILEC functionalities that they already receive as components of their retail telecommunications services.

Finally, we disagree with the contention that a Bill-and-Keep regime that shifts costs directly to both originating and terminating customers will not encourage additional spam and other unwanted messages. If a terminating retail or end user customer is charged separately for the cost of terminating traffic, there is no incentive for carriers to refrain from sending unsolicited messages to customers. We are unaware of any delivery service or entity (*i.e.*, U.S. Postal Service or package delivery service) that charges the terminating retail customer for delivery without prior agreement. We do not agree with the claim that "consumers have the incentive and the ability to avoid, or reduce the duration of, unwanted calls . . . ."[14] While

[14] *Appendix C* at 100.

consumers can certainly hang up on unwanted circuit-switched telemarketing calls, placing the entire burden on them to do so is blatantly unfair. The enormous popularity of "Do-Not-Call" lists indicates that most consumers do not want to be bothered with unsolicited phone calls. However, setting origination charges at zero under a Bill-and-Keep regime ignores those lessons and provides telemarketers incentives to ignore both federal and state "Do Not Call" lists.

The negative impact of Bill-and-Keep would not be limited to circuit-switched calls, however. If anything, the impact might be even worse with IP-based or packet-based messages. Consumers do not have the ability to avoid unsolicited, unwanted packet-based spam or messages without incurring costs (*i.e.*, changing computers, changing e-mail addresses, purchasing anti-spam or anti-spyware software). The frustration and the time spent trying to either avoid or recover from the unsolicited packet-based messages can also be substantial. This is not merely a major inconvenience to individuals. The time spent in the workplace by individual employees and employers' Information Technology (IT) and Data Processing (DP) personnel preventing and recovering from spam and unwanted e-mail messages is staggering and is becoming a drag on the nation's economy. While the impact of spam on e-commerce is unknown, the potential certainly exists to significantly interfere with e-commerce, as well.

Furthermore, as packet-based networks and traffic become more prevalent, and as people become even more dependent upon IP-based technologies in both their personal and professional lives, the limited ability of consumers and businesses to avoid unwanted e-mail, VoIP, or other packet-based messages will become even more detrimental. In summary, if a Bill-and-Keep approach with an origination charge of zero were adopted, there would be little in the way of technology and nothing in the way of pricing incentives to discourage unsolicited, unwanted IP-based spam or other messages.

C. Bill-and-Keep is not Competitively Neutral.

Appendix C contends that "[a] unified CPNP regime, however, would still afford carriers the opportunity to shift costs to competitors rather than recover these costs from their subscribers. Because this type of regime distorts the pricing signals received by consumers, it does not serve the Commission's goal of competitive neutrality."[15] An ILEC charges toll carriers and providers non-zero intercarrier rates because those toll carriers and providers are customers of the ILEC who are receiving services of value from the ILEC, and local transport and termination charges are made because one carrier is using another's network. In both cases, the Bill-and-Keep regime distorts the pricing signals received by carriers or providers that use the network facilities of others, by allowing other carriers and providers to originate or terminate traffic over each other's network at no charge.

Appendix C also states that ". . . an important benefit of a Bill-and-Keep regime is that it puts all carriers in a position where they must recover their own costs from their own retail customers. Under this regime, success in the marketplace will reflect a carrier's ability to serve customers efficiently, rather than its ability to extract payments from other carriers."[16] It is

[15] Id. at 104.

[16] Id. at 103.

unclear what the phrase "their own costs" means. This reference cannot be to the incremental cost of originating or terminating traffic, which FCC staff has suggested is at or close to zero. If this is a reference to network costs, it is unclear whether the reference is to the costs of a company's own network or to the costs of Carrier B's network that Carrier A is using. It is also unclear whether the proposal advocates that every carrier or provider should have a complete, end-to-end network. If so, this inevitably results in duplicative networks or network segments, or raises issues of allocative efficiency, among other problems. If not, then what is referred to as "extracting payments from other carriers" might really just be a matter of Carrier A recovering a portion of the costs of its network from Carrier B when Carrier B uses that network when acting as a wholesale customer of Carrier A.

D. Bill-and-Keep Requires Regulatory Intervention for Its Very Existence

According to *Appendix C*, "[a]lthough a Bill-and-Keep regime would call for Commission oversight during its implementation, the need for regulation after implementation would be greatly reduced as compared to the regulatory oversight required by a cost-based CPNP regime…[t]hus, although Bill-and-Keep may require additional regulatory oversight in the near term, we believe that such an approach is ultimately more deregulatory than the other alternatives proposed."[17] Contrary to these claims that Bill-and-Keep is deregulatory in nature or that it would greatly reduce the need for regulation after implementation, Bill-and-Keep requires regulatory intervention for its very existence.

Companies that want to provide service are faced with a fundamental choice of whether to install their own network facilities, purchase services from another company, or lease capacity on another company's network. This is a form of the "build or buy" decision that confronts companies in many industries and markets, not just in the telecommunications industry. Such a decision normally, although perhaps not always, presupposes that the company facing this decision will incur a positive cost regardless of which course of action it takes. We do not know of any other industry in which a company would routinely expect that, if it chose the "buy" option rather than the "build" option, it would not have to pay its wholesale suppliers for use of the supplier's facilities or for services rendered.

Just as would be expected in these other industries, regardless of the type of carrier involved, transport and termination network facilities are not costless.[18] Bill-and-Keep runs counter to the principle of market pricing and would seriously distort the market because it relies upon the regulatory intervention of a mandatory zero cost scheme for its very existence. Bill-and-Keep sends incorrect pricing signals to wholesale and retail customers and carriers terminating and transporting traffic from another carrier because of the shifting of all costs to end users. We are not arguing that costs for end users should be zero; we are merely arguing at a minimum for a more balanced allocation of costs between end users and carriers compared to what the FCC staff has proposed. A government mandate to implement Bill-and-Keep would not make the pricing signals more accurate; it would simply make them incorrect government-mandated price signals.

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[17] Id. at 108-109.

[18] The build-or-buy scenario may apply to some types of transport facilities and traffic as well.

E. Bill-and-Keep Creates Improper Incentives for Arbitrage, Market Structure and Public Policy.

We must also address the incentives that a Bill-and-Keep approach creates. By not recognizing that Bill-and-Keep depends upon regulatory intervention for its very existence, the proposal in *Appendix C* fails to recognize that a Bill-and-Keep regime, if implemented, would likely "revise or rearrange transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation, would be viewed as costly or inefficient."[19] This is the very behavior such a proposal should try to avoid. To the extent that unifying rates is viewed as a means to eliminate arbitrage opportunities, the proposal fails to demonstrate why that must lead to implementing a Bill-and-Keep mechanism in which intercarrier compensation rates are set at zero by regulatory fiat. There is no exploration of the possibility that unifying rates at some other level could also eliminate arbitrage opportunities. Moreover, advocating a Bill-and-Keep methodology that shifts all costs to end users promotes a broad industry policy that picks winners and losers within the telecommunications marketplace.

F. Bill-and-Keep Does Not Support the Goals of Universal Service.

Origination and termination rates set at zero could result in increases in the amount of universal service fund ("USF") support needed, despite additional recovery options from end users, over and above the amount that would be needed if originating and terminating intercarrier compensation rates were set at more rational levels. The amounts necessary to offset any reductions in origination and termination are not presently calculable because data is incomplete and markets within and between states vary. Thus, a one-size-fits-all approach will not benefit states where universal service is concerned. Each state will have to assess its own need and determine the appropriate USF levels independently. Bill-and-Keep causes more regulatory uncertainty than it resolves in this regard.

In *Appendix C*, FCC staff notes that many commenters have significant concerns regarding a Bill-and-Keep regime's overall impact on end-user consumers.[20] Questions regarding affordability in and rate comparability among states are primary drivers for this debate. FCC staff is keenly aware of the existing issues surrounding universal service, in part because of the FCC's recent decisions on the subject, and the maintenance of the most efficient, affordable options for telephone service, particularly for high-cost rural areas. Specifically, *Appendix C* states that currently, funding universal service through a CPNP regime means that rates are set above incremental or marginal cost, which may discourage efficient usage of the network.[21] The staff proposal does acknowledge that it will be necessary to address the overall affordability impact to the Commission's existing explicit universal service mechanisms, which may result in additional universal service funding commitments. While the statement regarding CPNP does not expressly identify a type of rate, the rationale is counter-balanced with the

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[19] *Appendix C* at 103 (quoting *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, ¶ 12).

[20] Id. at 109.

[21] Id. at 99, n. 22.

assertion that a CPNP regime may not address call externalities, and thus the impact on rates, any better than a Bill-and-Keep regime. If a Bill-and-Keep approach reduces access charges so significantly that it ultimately strains the Federal Universal Service Fund to the point of unsustainability, then alternative and explicit measures for revenue recovery will be a necessity.

As the FCC staff has correctly noted, it is important to observe that any type of regime implemented by the Commission must, in some fashion, generalize the benefits and costs in order to move forward toward a single intercarrier compensation approach. Realistically, there will not be a perfect, one-size-fits-all approach for every carrier in every state. That also provides a compelling argument for the sort of state role advanced in the NARUC Task Force Intercarrier Compensation Plan Version VII. To that end, there will be significant policy concerns and problems that need to be addressed long after the effective date of an Order. The crucial element at this point is to seek a solution that represents a fair and rational balance. FCC Staff has underscored the necessity of examining these issues on their own merit and recognizing the importance of doing so sooner rather than later.

IV. Conclusion

The IURC appreciates the opportunity to make its initial comments on the *FNPRM*. We look forward to continuing participation in the rulemaking and activities of the Task Force.

Respectfully submitted,

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